

## Message Text

CONFIDENTIAL

PAGE 01 PORT M 00288 010553Z

16

ACTION EA-10

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EB-07 FRB-03 INR-07 NSAE-00 TRSE-00 XMB-02 OPIC-03

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PA-01 PRS-01 USIA-06 EPA-01 CEQ-01 OFA-01 /106 W

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R 010256Z APR 75

FM AMCONSUL PORT MORESBY

TO SECSTATE WASHDC 0412

INFO AMEMBASSY CANBERRA

AMEMBASSY KINSHASA

AMEMBASSY LIMA

AMEMBASSY LUSAKA

AMEMBASSY SANTIAGO

AMCONSUL SYDNEY

AMEMBASSY TOKYO

C O N F I D E N T I A L PORT MORESBY 0288

E.O. 11652: GDS

TAGS: EMIN, EIND, PP

SUBJECT: KENNECOTT OK TEDI COPPER PROJECT: THE TALKS BREAKDOWN

REF: A. PORT MORESBY 0219; B. PORT MORESBY 0254

1. BEGIN SUMMARY: NEGOTIATIONS BETWEEN THE GPNG AND KENNECOTT PNG LTD. WERE APPARENTLY IRREPARABLY RUPTURED BY THE ANNOUNCEMENT MADE IN THE HOUSE OF ASSEMBLY MARCH 12, 1975, BY CHIEF MINISTER MICHAEL SOMARE. HE STATED THAT SINCE NEGOTIATIONS, STRETCHING BACK TO 1971, HAD PRODUCED NO AGREEMENT HIS GOVERNMENT WOULD NOT RENEW OR EXTEND THE KENNECOTT MINING LEASES FOR THE OK TEDI PROJECT IN THE STAR MOUNTAINS OF PNG. THE COMPANY WOULD LOSE ITS \$18 MILLION INVESTMENT, BUT MIGHT EITHER MANAGE THE NEW DRILLING PROGRAM  
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 PORT M 00288 010553Z

SUPPORTED BY GPNG FUNDS OR POSSIBLY COME BACK IN LATER.

KEITH HULLEY, KENNECOTT'S CHIEF NEGOTIATOR, PRIVATELY STATED THAT KENNECOTT WAS "DEFINITELY OUT." THERE WAS A VERY SMALL CHANCE IT WOULD BE INVOLVED LATER IF ADDITIONAL RESERVES WERE FOUND ADDING TO THE COPPER ORE BODY OF 150 MILLION TONS. HULLEY STATED KENNECOTT WOULD CLOSE UP OFFICES, TERMINATE ITS PNG EMPLOYEES, AND QUIT THE MINE SITE WHERE IT HAS BEEN OPERATING SINCE 1968. THE KENNECOTT PRESENCE WILL BE FULLY WITHDRAWN BY THE END OF APRIL 1975. END SUMMARY.

2. THE PUBLIC PRONOUNCEMENTS OF CHIEF MINISTER SOMARE ARE AT SOME VARIANCE WITH THE STATEMENTS OF KENNECOTT'S CHIEF NEGOTIATOR, SYDNEY BASED MANAGING DIRECTOR, KEITH HULLEY. SOMARE STATED THAT TALKS BETWEEN THE GOVERNMENT AND KENNECOTT "ARE NOT YET FORMALLY COMPLETED" AND "INDEED, IN ONE SENSE THEY MAY BE SAID TO HAVE JUST ENTERED A NEW PHASE." HULLEY STATED THAT KENNECOTT WAS DEFINITELY OUT OF THE OK TEDI PROJECT. HE STRONGLY DENIED THIS WAS A NEGOTIATING PLOY. THE TWO KEY AREAS OF CONTENTION (SEE REF A) WERE NEVER RESOLVED DESPITE SOMARE'S STATEMENT HIS NEGOTIATORS BELIEVED THAT HAD THE QUESTION OF PROFITABILITY BEEN AGREED UPON THEN THAT OF INTERNATIONAL ARBITRATION COULD HAVE BEEN OVERCOME.

3. HULLEY SAID THE PROBLEM OF APPEALING OUTSIDE THE PNG LEGAL SYSTEM IN CASE OF SERIOUS DISPUTE BETWEEN THE GPNG AND KENNECOTT WAS NEVER AGREED TO BY THE GOVERNMENT SIDE AND THAT KENNECOTT HAD NO INTENTION OF ABANDONING ITS POSITION DEMANDING INTERNATIONAL ARBITRATION FOR SHORT-TERM GAINS.

4. THE QUESTION OF PROFITS WAS THE THORNIEST ISSUE ON THE NEGOTIATING TABLE. THE GPNG WAVERED ONCE FROM ITS STAND THAT 15 PERCENT RETURN ON INVESTMENT WAS ALL IT WOULD ACCEPT. HOWEVER, WHEN KENNECOTT REFUSED THE SMALL, ADDITIONAL INCENTIVE, THE GOVERNMENT SIDE QUICKLY WITHDREW THE OFFER WITH WHAT HULLEY CHARACTERIZED AS "RELIEF." IT REMAINED THE GOVERNMENT'S POSITION THAT IT WOULD GIVE KENNECOTT NO BETTER A DEAL THAN IT HAD BOUGAINVILLE COPPER. HULLEY WAS QUICK TO POINT OUT THAT BOUGAINVILLE WOULD NEVER HAVE

CONFIDENTIAL

PAGE 03 PORT M 00288 010553Z

EXPLOITED THE PANGUNA MINE FOR 15 PERCENT RETURN AND KENNECOTT WOULD NOT DO SO AT THE OK TEDI WHICH WAS LESS RICH AND HAD SMALLER ORE RESERVES.

5. APPARENTLY REFUSAL TO EXTEND THE MINE LEASES CRYSTALIZED WHEN GOVERNMENT OFFICIALS REALIZED KENNECOTT HAD DONE NO EXPLORATORY DRILLING SINCE 1971. THEY SAW NO REASON TO CONTINUE THE DELAY WHILE NEGOTIATING WITH KENNECOTT AND

APPARENTLY FELT AGREEMENT WAS NO CLOSER THAN IT HAD BEEN A YEAR BEFORE. HULLEY WAS SOMEWHAT BITTER ABOUT PRESS STATEMENTS ACCUSING KENNECOTT OF "DRAGGING ITS FEET" IN NEGOTIATING. HE SAID THAT WHEN KENNECOTT DECIDED IN 1971 IT NEEDED TO KNOW IF A MUTUALLY ACCEPTABLE AGREEMENT FOR COMMERCIAL EXPLOITATION OF THE OK TEDI COPPER WAS POSSIBLE, IT BEGAN IMMEDIATELY TO DEAL WITH AN AUSTRALIAN GROUP. ACCORDING TO HULLEY, THEY WERE CLOSE TO AN AGREEMENT ALONG THE BOUGAINVILLE COPPER LINES WHEN SELF-GOVERNMENT INTERVENED AND THE GROUP WAS DISSOLVED. THE COMPANY SOUGHT FOR NINE MONTHS TO REOPEN NEGOTIATIONS WITH THE PNG GOVERNMENT, BUT ONLY SUCCEEDED IN NEGOTIATING SERIOUSLY AND RELATIVELY CONTINUOUSLY IN JUNE 1974. DURING THIS PERIOD, ANOTHER \$1.5 MILLION WAS SPENT BY THE COMPANY.

6. KENNECOTT PLANS TO TURN ALL ITS FINDINGS OVER TO THE GOVERNMENT AND WILL BE AS FORTHCOMING AS POSSIBLE, ACCORDING TO HULLEY. MOST OF ITS PNG EMPLOYEES WILL REMAIN WITH THE PROJECT UNDER GOVERNMENT AUSPICES. CHIEF MINISTER SOMARE INSISTS EXPLORATION WILL CONTINUE UNTIL EITHER SUFFICIENT ORE RESERVES ARE PROVED OR DISPROVED. HULLEY STATED THAT THERE WAS LESS THAN A FIFTY-FIFTY CHANCE OF FINDING ADDITIONAL RESERVES SUFFICIENT TO MAKE THE OK TEDI COMMERCIALY VIABLE. HE ADMITTED THIS MIGHT NOT BE A PROBLEM IN TEN YEARS WHEN COPPER PRICES WOULD DOUBTLESSLY BE CONSIDERABLY HIGHER. IN THE MEANTIME, THE GOVERNMENT INTENDS TO HAVE A COMPANY SUCH AS CRA MANAGE THE EXPLORATION WORK AT GOVERNMENT EXPENSE.

7. THE SOMARE GOVERNMENT APPARENTLY WAVERED AT ONE POINT, BUT FINALLY HELD TO ITS RESOLVE THAT NO COPPER COMPANY WOULD RECEIVE A BETTER DEAL THAN BOUGAINVILLE COPPER. ITS COMMITMENT TO THE BOND RATE PLUS FOUR PERCENT RETURN ON INVESTMENT WAS TOTALLY UNACCEPTABLE TO KENNECOTT. CONFIDENTIAL

CONFIDENTIAL

PAGE 04 PORT M 00288 010553Z

HULLEY POINTED OUT THAT SHOULD THE BOND RATE DROP TO 6 PERCENT, BOUGAINVILLE WOULD RECEIVE 10 PERCENT RETURN. HE CONTENDED THAT NO MULTINATIONAL WOULD ACCEPT THIS KIND OF RETURN GIVEN THE RISKS ENTAILED TO THE SIZE OF INVESTMENT.

8. COMMENT: THE FAILURE OF THE NEGOTIATIONS MAY EVENTUALLY FORCE A REAPPRAISAL WITHIN THE SOMARE GOVERNMENT, ESPECIALLY WITH REGARD TO PROFITABILITY AND INTERNATIONAL ARBITRATION. FOR THE MOMENT, HOWEVER, IT SEEMS CERTAIN THAT GPNG WILL TRY AND SHOW FOREIGN INVESTORS AND PAPUA NEW GUINEANS THAT THE GOVERNMENT POSITION IS CORRECT AND ULTIMATELY THE MOST BENEFICIAL FOR PNG DEVELOPMENT. END COMMENT. OLMSTED

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